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Kraft..."Good food and good food ideas."

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Kraft, Inc. 1987 Annual Report

Financial Highlights[a]

(Dollars in millions, except per share)	1987	1986	1985
Net sales	$9,876	$7,780	$7,065
Net income from continuing operations	$ 435[b]	$ 394	$ 362
Per share	3.20[b]	2.79	2.50
Net income from discontinued operations	$ 54	$ 19	$ 104
Per share	.40	.14	.72
Net income	$ 489	$ 413	$ 466
Per share	3.60	2.93	3.22
Dividends paid	$ 249	$ 234	$ 219
Per share	1.84	1.68	1.52⅓
Working capital	$ 79	$ 37	$ 723
Shareholders' equity [c]	$1,898	$1,798	$2,880
Per share	14.47	13.29	19.95
Return on average equity [c] [d]	26.5%	17.7%	17.0%
Return on average total capital [c] [d]	17.7%	14.4%	14.7%
Long-term debt to equity [c]	47.2%	13.2%	15.6%
Total debt to total capital [c]	45.4%	34.4%	16.8%
Capital expenditures	$ 256	$ 162	$ 113
Average number of common and common equivalent shares (thousands)	136,112	140,970	144,898

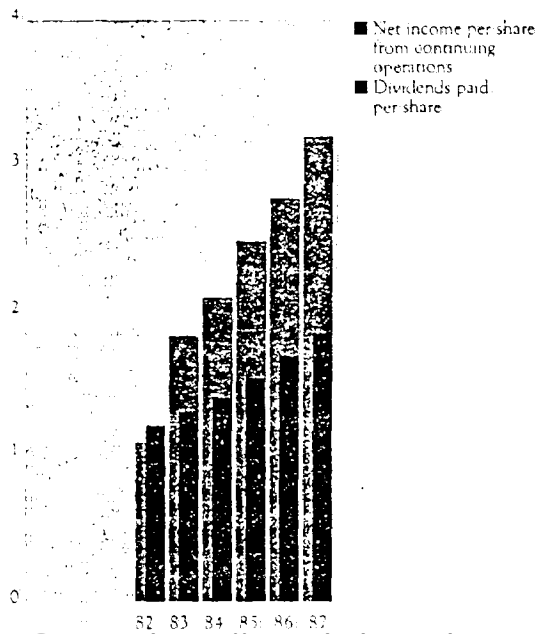
(a) Amounts for years prior to 1987 have been restated to classify results of the discontinued Duracell businesses separately from continuing operations and to reclassify assets and liabilities of the Duracell businesses as net assets of discontinued operations. Data related to shareholders' equity are not affected by this restatement.

(b) Net income from continuing operations for 1987 includes the cumulative effect of the adoption of the new accounting standard for income taxes of $45.2 million (33 cents per share) substantially offset by an additional tax provision of $45.0 million (33 cents per share) related to the restructuring of the capital of certain international subsidiaries.

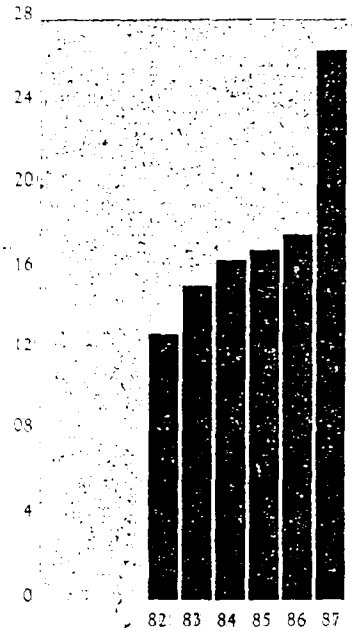
(c) Shareholders' equity reflects the 1986 spinoff of Premark International, Inc. (Premark) and the repurchase of shares in 1987 and 1986.

(d) Returns include results of continuing and discontinued operations.

Net Income Per Share from Continuing Operations and Dividends Paid Per Share



Return on Average Equity



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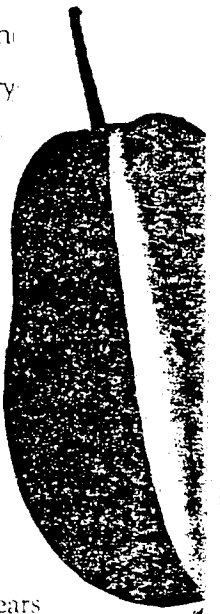
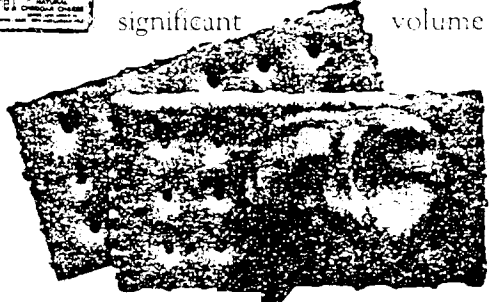
Operations Review

U.S. Consumer Food operating profit advanced 9 percent to $593 million and sales rose 13 percent to $4.5 billion. Tonnage exceeded the year-ago level by 11 percent.

Refrigerated Products Group, essentially Kraft's domestic cheese business, had another outstanding year as it achieved substantial gains in profit on higher tonnage and sales. Group results benefited from good expense control, lower cheese costs and modest price increases. In a year marked by intense competitive activity, volume growth was generated by all three of its major product categories – natural, process and cream cheese. Also contributing to overall growth were the *Chunky* and *Purity* specialty cheese lines and the *Polly-O* brand of Italian cheeses. Purity was acquired mid-year as part of the Anderson Clayton Foods purchase. To compete more effectively in the marketplace, Refrigerated Products Group strengthened its brand management system by regrouping individual marketing, research and development and manufacturing teams around its core categories: natural cheese, sandwiches, recipe uses, snacks and spreads – which are reflective of consumer uses of Kraft's wide range of cheese products. Every indication is that this approach will enhance competitiveness and lead to the identification of new products that complement the respective category profiles. As in recent years, the group has also benefited from its strategically focused regional sales program. In natural cheese, for example, special promotional programs for its flagship brand, *Kraft* 100% Naturals, generated volume and share gains. Extensions of the group's natural cheese line, *Kraft* 100% Natural Shreds and *Kraft* Light Naturals, a reduced-fat, low-cholesterol cheese that has been expanded into 40 percent of the U.S. market, shared in the success of this localized effort. Sandwich cheese, the category which includes *Kraft* Singles, achieved its highest share in two years due in part to clearer positioning of all of Kraft's branded slice cheese. Line extensions, particularly *Velveeta* slices which is targeted to more price-conscious consumers, and *Kraft* Deluxe Slices added new depth to Kraft's already strong lineup in this business along with significant volume gains. Recipe cheese performance was led by *Cheez Whiz*





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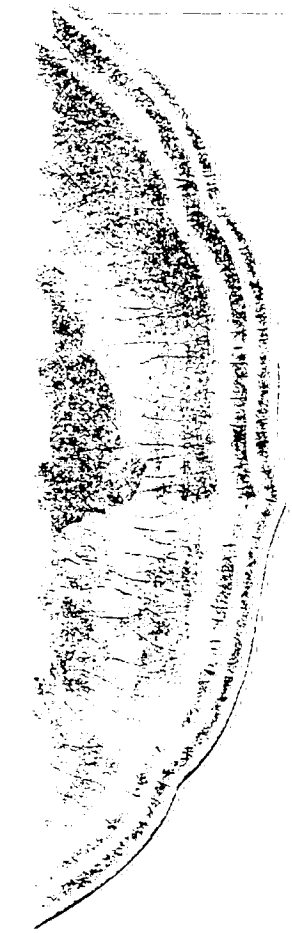
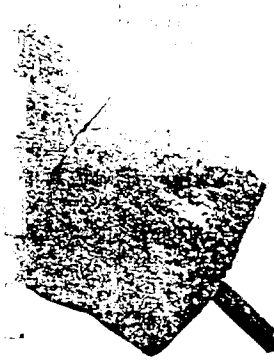


pasteurized process cheese spread, which was repositioned in 1986 as a microwavable cheese sauce. In 1987, as in 1986, *Cheez Whiz* achieved record tonnage on the crest of its transition into this growing segment of convenience products. Marketing activity and advertising during the year for *Philadelphia Brand* cream cheese continued to stress that it has "half the calories" of butter or margarine. Also in the year, the national rollout of Light *Philadelphia Brand* process cream cheese product was completed. **R**efrigerated Products Group anticipates that 1988 will be another year of increased profit, tonnage and sales as its core strategies aimed at increasing cheese usage through better matching of products and consumer needs and sharpened product differentiation remain on track.

Grocery Products Group experienced intense competitive activity in most of its major product categories, particularly margarine, mayonnaise and barbecue sauce. While tonnage was up, sales were unchanged and profit declined. Nonetheless, as a result of aggressive trade spending, the strong market positions held by the group were sustained at or near their historic high levels. **K**raft's acquisition of Anderson Clayton Foods directly benefited the group as it integrated into its operations *Seven Seas*, a leading brand of pourable dressings particularly in the eastern United States where Kraft in the past has not been strong. *Kraft* pourable dressings made steady progress, aided by the national expansion of selected mainline flavors in convenient, new squeezable packaging and volume growth in *Kraft* reduced-calorie pourable dressings. **M***iracle Whip* salad dressing posted overall sales and tonnage gains attributable in part to the ever-increasing popularity of *Miracle Whip* Light reduced-calorie salad dressing. *Kraft* Light reduced-calorie mayonnaise also performed well as it countered aggressive competition which adversely affected *Kraft* real mayonnaise. **K**raft remains the undisputed leader of the barbecue sauce category despite modest share erosion in the *Kraft*-branded line. The group's *Bull's-Eye* brand, which is the taste leader in the super-premium segment and is now in national distribution, grew significantly. **W**ith regard to growth in the packaged dinners category, Kraft recorded tonnage and sales gains over particularly strong 1986 levels. Contributing to volume gains was the performance of *Velveeta* shells & cheese dinners, which holds a strong number-two position. Moreover, Kraft expanded its line of easy-to-prepare dinners



The six-item line of *Kraft* frozen dinners has done so well in test market that it will be expanded quickly into new markets.

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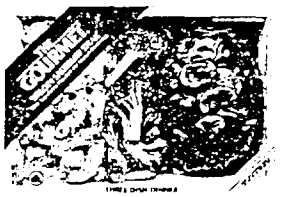
with *Chicken Applause!* add-meat dinners. In the intensely competitive margarine category, a vigorous defense was mounted for *Parkay* margarine. The result was exceptional tonnage and share growth for this leading brand in 1987, but at the expense of profitability.

Frozen Foods Group is composed of Tombstone Pizza Corporation, Lender's Bagel Bakery and The All American Gourmet Company, manufacturer and marketer of *The Budget Gourmet* line of frozen entrees, dinners and side dishes which was acquired in July. Profit, sales and tonnage levels for the group were strong in 1987. All American Gourmet's profit performance exceeded its acquisition plan target. Combined, its original line and reduced-calorie entrees have achieved the number-two brand national share of frozen single-dish entrees. Building upon the entree business, All American Gourmet's *Three Dish Dinner* line was expanded nationally in 1987 and a new 20-item line of side dishes was introduced into approximately 20 percent of the U.S. market. Tombstone Pizza Corporation, with sales and tonnage up briskly and well ahead of the total pizza category, had an outstanding year in profit. Following the recent expansion of Tombstone's store-door distribution system to Atlanta, Houston, San Antonio and Austin, the business is now represented in 30 percent of the U.S. market. Despite its regional distribution, Tombstone holds the number-two share position among regional and national frozen pizza brands. Complementing strong 1987 results in its base business, Tombstone firmly established its super-premium pizza brand, *Double Top*, and successfully launched a new microwavable pizza. In a very competitive environment, Lender's posted record profit on strong volume gains. During the year, Lender's joined promotionally with Burger King in developing its new breakfast bagel sandwich, which has become a permanent item on this fast-food chain's menu. Also contributing to increased bagel consumption were business-building opportunities with *Philadelphia Brand* cream cheese. In other areas, Frozen Foods Group is expanding distribution of *Kraft* frozen pasta entrees, an internally conceived and developed new microwavable product line that was successfully test marketed in 1987. These mainstream frozen entrees not only have strong business potential but fit strategically with All American Gourmet.



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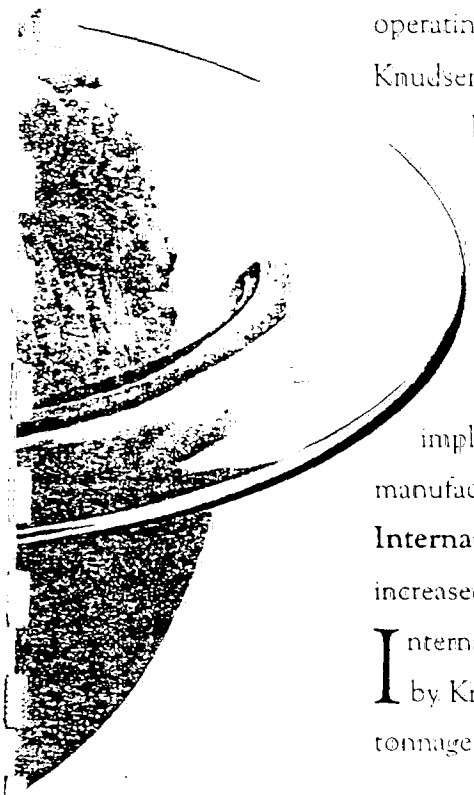
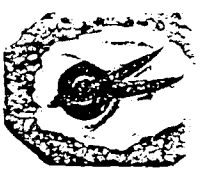
Dairy Group had a mixed year. Tonnage and sales were up but profit advanced less than anticipated due to higher manufacturing and raw material costs. The group's frozen desserts recovered from 1986 problems associated with the midsummer market withdrawal of the group's novelty ice cream squares. *Breyers* ice cream tonnage was well ahead of last year, with added impetus coming from the continued success of the brand's expansion into markets west of the Mississippi. *Sealtest* ice cream and *Frusen Glädjé* super-premium ice cream tonnage was lower as a result of competitive pressures during the year. Cultured dairy products were strong performers in 1987, with *Light n' Lively* lowfat yogurt and *Breyers* yogurt tonnage up significantly. *Light n' Lively* yogurt posted record high volume levels each quarter, and *Breyers* yogurt, which generated excellent tonnage for the year, continued to gain favor among consumers with its *Full-of-Fruit* formulation. *Breakstone's* and *Sealtest* sour cream and *Breakstone's* and *Light n' Lively* cottage cheese also achieved solid tonnage increases. With the acquisition last year of the Knudsen operation on the West Coast, Dairy Group secured manufacturing, marketing and distribution channels through which it can further its expansion programs. Although Knudsen's full-year results did not meet initial expectations, this business is currently operating profitably. During the year, substantial progress was made toward regaining Knudsen's historically strong market positions in ice cream and yogurt, while record high share levels were achieved by its cottage cheese and sour cream products.



In 1987, Dairy Group upgraded a number of its facilities and closed its Jacksonville, Fla., and Peoria, Ill., plants, resulting in overhead reductions and increased economies of scale. Plans also call for the closing of its Syracuse, N.Y., plant. Dairy Group is expecting significantly improved financial performance in 1988. Key to its profitability will be the successful implementation of productivity improvement actions covering packaging, manufacturing costs, overhead, distribution and inventory management.



International Food profit rose 26 percent to $230 million and sales increased 16 percent to $2.3 billion.

International Group capitalized on the volume momentum established in 1986 by Kraft's core brands. The group benefited from a 3-percent increase in tonnage, cost reductions worldwide from improved manufacturing

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efficiencies, productivity gains and lower raw material costs. **P**rofit increased significantly in Europe with especially strong performances in Italy, Germany, the United Kingdom and Spain. Substantial gains were also achieved in Canada and Australia. **H**igher tonnage and lower product costs were largely the factors behind the success of Kraft's operations in Italy, the company's largest profit center in Europe. Contributing strongly to the volume gains were *Jocca* cottage cheese; *Mato Mato* ketchup, which is also being marketed in squeezable bottles; *Kraft* mayonnaise; *Sottilette* process cheese slices; *Philadelphia Brand* cream cheese; and *Invernizzi* cheese products. **I**n Germany, Kraft had an excellent year with profit up sharply on higher tonnage, lower product costs and a favorable product mix. Tonnage growth was supplemented by the successful launch of new products, which included Light *Philadelphia Brand* cream cheese; *Cravattini*, a line extension of *Miracoli* packaged pasta dinners; and *Bella'ita* reduced-calorie mayonnaise. **P**rofit in the United Kingdom advanced strongly due to the performance of core brands and lower product costs. Virtually all core brands achieved higher volumes with *Vitalite* sunflower oil-based margarine, *Golden Churn* spread, *Philadelphia Brand* cream cheese and the operation's frozen food products reporting the largest increases. **P**rofit in Canada rose on good gains in its core grocery business along with improved productivity. Effective advertising and the introduction of new products, including *P'tit Quebec* mozzarella and brick cheeses, *Cheez Whiz* Light pasteurized process cheese spread and new flavors for *Philadelphia Brand* cream cheese dips contributed to the improved performance. Good volume gains in items produced for foodservice distribution in Canada were also achieved. **I**n the Pacific area, Kraft Australia turned in healthy profit gains behind effective promotional programs and extended distribution activity, both of which lifted tonnage over the 1986 level. Among its major retail product categories, *Kraft* processed cheddar cheese loaves, *Philadelphia Brand* cream cheese, *Kraft* pourable dressings, *Vegemite* yeast spread and *Kraft* peanut butter

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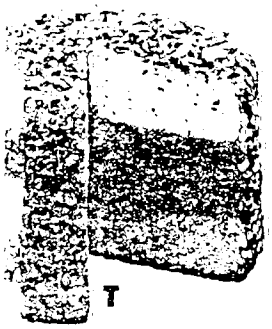
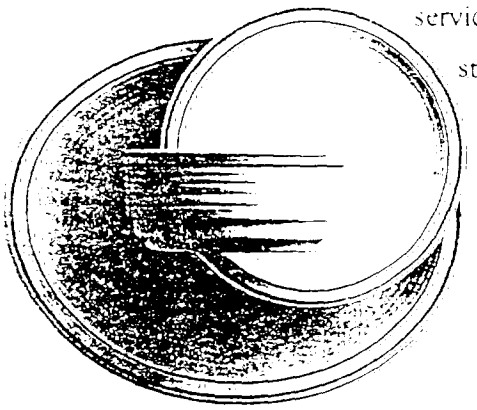


produced good growth during the year. Kraft's business in the Philippines continued to make advances, particularly in process cheese. In Latin America, sales were up but profit was off from last year. In Mexico, tonnage rose in nearly all product categories while profit declined on higher costs. Kraft operations in Venezuela and Panama continued to experience difficult economic conditions which depressed profit and tonnage.

U.S. Commercial Food operating profit rose 9 percent to $86 million. Sales increased 72 percent to $3.0 billion and tonnage was up 61 percent, due mostly to acquisitions.

Foodservice Group tonnage and sales nearly doubled, primarily as a result of the addition of distributors acquired in 1986 and 1987. Profit advanced less than anticipated due to costs associated with integrating these businesses into Kraft. Since 1986, Kraft Foodservice has acquired 19 independent foodservice distributors, six in 1987. With this expansion program substantially completed, the group made considerable progress during the year on the integration of these new businesses into its operations. By year end, Kraft Foodservice's distribution system, which now covers 97 percent of the U.S. market, had risen from fourth to second place in this highly fragmented industry. Kraft brings some significant advantages to the business. For one, the company is the only competitor providing its own strong, nationally recognized branded food products which, in 1987, represented nearly one quarter of Kraft Foodservice sales volume. Other competitive advantages include custom product formulation by Kraft's Technology Center, customer and market research expertise, custom packaging capability and substantial portion-control capacity. Already these strengths have earned Kraft Foodservice valuable business with the major restaurant and fast-food chains that require quality, consistency and customized products. Kraft Foodservice is also concentrating on other growth opportunities, including a national program to service supermarket and convenience store delicatessens, bakery departments and salad bars. The company will continue to make investments in foodservice in 1988, primarily in the area of information systems, which should enable Kraft Foodservice to achieve significant economies and further strengthen its customer service capability.



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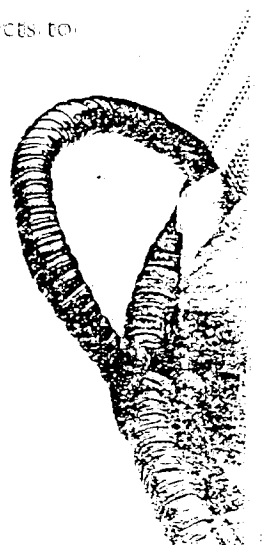
Food Ingredients Group, formerly known as Industrial Foods Group, enhanced its market leadership position in 1987 with the June acquisition of the Anderson Clayton edible-oil business. Including Anderson Clayton's results for the second half of the year, Food Ingredients Group tonnage and sales were up strongly. Operating profit was slightly lower than last year's level, which benefited from a real estate property gain. The Anderson Clayton acquisition has produced a good balance of strong businesses serving customers in all three channels of food distribution – foodservice, food processing and retail through private label and selected branded products – and is building a larger base in specialty ingredients as well. Kraft is now better positioned to capitalize on the good growth potential for food ingredients. In its specialty ingredients business, the group continued to show growth, providing a wide variety of products to food processors. While reduced demand for dehydrated marshmallow bits resulted in an overall volume decline, specialty ingredients enjoyed volume growth during the year in cream cheese, natural cheese, caramels and baking ingredients. In 1988, Food Ingredients Group expects significant volume growth and good gains in operating profit, reflecting the full-year contribution of the Anderson Clayton business along with cost reductions and the scale efficiencies of the combined businesses.

On December 3, 1987, Kraft announced its intent to sell Duracell Inc. Consequently, Duracell is being treated as a discontinued operation for financial reporting purposes. In 1987, Duracell was a significant contributor to Kraft's overall financial performance as its operations continued throughout the year to gain momentum, culminating with excellent results in the fourth quarter when battery sales are at their highest. Duracell net income climbed to $54 million compared with a loss of $4 million in 1986, which reflects an after-tax charge of $26 million related to the refocusing of its activities on its core alkaline battery business. Duracell's sales in 1987 rose 18 percent to $1.1 billion from $963 million. Kraft expects to complete the sale of Duracell by mid-1988.



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